

**STATEMENT OF JOEL SZABAT
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U.S DEPARTMENT OF TRANSPORTATION**

BEFORE THE

**COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
U.S. HOUSE OF REPRESENTATIVES
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Disadvantaged Business Enterprise Program

Chairman Oberstar, Ranking Member Mica, and Members of the Committee.

Thank you for inviting the U. S. Department of Transportation (DOT) here today to discuss our Disadvantaged Business Enterprise (DBE) program.

My name is Joel Szabat and I am the Deputy Assistant Secretary for Transportation Policy. With me today is Robert Ashby, the Deputy Assistant General Counsel for Regulation and Enforcement. Mr. Ashby has worked closely with our DBE program since its inception, and has been the primary drafter of the Department's regulations on the subject.

The DBE program, enacted in 1983 as part of the Surface Transportation Assistance Act (STAA) of 1982, was designed as a vehicle to increase the participation by small businesses owned and controlled by socially and economically disadvantaged individuals in federally assisted state and local contracts. Three major DOT operating administrations are involved in the DBE program: the Federal Highway Administration, the Federal Aviation Administration and the Federal Transit Administration.

An individual must be socially and economically disadvantaged to qualify his or her firm as a DBE. All *bona fide* African-American, Asian-American, Hispanic-American, Native-American and women-owned businesses are rebuttably presumed to be disadvantaged. Others may qualify on a case-by-case basis. The personal net worth of a DBE owner can not exceed \$750,000, and the total gross receipts to a DBE can not exceed a \$22.41 million annual average.

In Fiscal Year 2008, DOT distributed more than \$40 billion in formula and other grant funds, which resulted in over \$30 billion in contracting and subcontracting opportunities for small and disadvantaged businesses. DBEs were awarded \$3.3 billion in contracts, representing over 11% of the total DOT assisted contracting.

The success of the DBE program is not measured solely in dollars or percentages. Across the country, DBEs are growing to the point of graduating from the program and, in many cases, becoming respected prime contractors.

For example:

- Myles Construction Company, after receiving assistance from the South Carolina DOT Business Development Center, advanced from subcontractor to prime contractor status, and recently was the low bidder on a project totaling \$1.7 million dollars.
- In Illinois, Millennia Professional Services, a Hispanic-owned DBE engineering consulting firm, was founded and certified in 2004 by four partners working out of their basements. They started with two full-time employees and revenue of \$76,000 in 2004, grew to 10 full-time employees, eight part-time employees, revenue of \$1,408,000, and were awarded their first project as a prime consultant by 2007.
- In 2008, Millennia landed their second project as a prime consultant, employed nine full-time employees and 21 part-time employees, and had revenue of \$2.0 million. They currently specialize in construction architecture.

We would like to provide for the record a selection of additional “success stories” that illustrate the benefits of the DBE program to individual firms and the innovative steps that many States are taking to help DBEs grow and prosper.

The DBE program in its present form has been an important part of DOT’s financial assistance programs since 1999, and its antecedents reach back to 1980. Congress has enacted DBE or similar program requirements as part of every highway/transit authorization act since 1983, and similar requirements for airport programs were first codified in 1987. This is a program that has received bipartisan support from Administrations and Congresses controlled by both major parties.

In 1999, the Department issued a revised DBE regulation intended to meet the most stringent “strict scrutiny” constitutional requirements articulated for programs of this kind by the Supreme Court. Since then, every Federal court that has reviewed the DBE rule has found it to be constitutional. We would like to provide for the record a summary of those cases.

Why is the program constitutional? The courts speak of two requirements for the DBE program. First, there must be a compelling need for the program, such as the need to combat discrimination and its continuing effects. Second, the administration of the program must be narrowly tailored to address discrimination and its effects. The DBE regulation that the Department issued in 1999 focused on this second requirement.

In that rule, which continues, with minor modifications, to govern the program, we forbade the use of DBE set-asides and quotas. Only individuals who are genuinely socially and economically disadvantaged are eligible to participate, something we made clear by imposing a limit on the personal net worth of participants. Women or members of minority groups who are too wealthy do not get to participate, while individuals who are

not members of one of the designated groups can participate if they make an individual case that they are socially and economically disadvantaged.

We told state and local governments to use the best evidence available to estimate the DBE participation they could expect to obtain if there were a nondiscriminatory level playing field. This evidence-based estimate, and not some arbitrarily chosen number, must be the basis for each DOT recipient's annual program goal. We then told our recipients that they must achieve as much as possible of that annual goal through what we call "race-neutral" means, not involving the use of techniques that are based on the race or gender of business owners. Outreach, technical and bonding assistance, unbundling of contracts, and small business programs are among the race-neutral measures that we encourage recipients to use.

Only where a state or local government determines that it cannot achieve its "level playing field" goal solely through the use of race-neutral means does that government employ what we call "race-conscious" means, such as setting contract-specific goals for DBEs. Where there is a contract goal, we insisted that what matters in awarding a contract is that bidders make good faith efforts to use DBEs, which they can do either by meeting a goal or by documenting the efforts they made to meet the goal. We've made it very clear that nobody is required simply to "hit the number" in order to get a contract.

There is a great deal of flexibility in the DBE program. This flexibility allows recipients to implement their program without setting race conscious contract goals when not needed to ensure a discrimination-free market, and some recipients have all race-neutral programs. Where needed to narrowly tailor the program, the Department will grant waivers to recipients to permit them to focus their race-conscious goals only on groups for which there is evidence from a disparity study of underutilization. We have recently granted such waivers to California and Oregon. As provided in the DBE rule, recipients are not penalized for failing to meet their goals, though we use any shortfalls in evaluating program success and working with recipients to improve their programs.

Courts have noted these features of our regulation as reasons for finding that the DBE program meets the narrow tailoring requirement. But a narrowly tailored program passes constitutional muster only when there is a compelling need for having the program in the first place. That is where this Committee and the Congress as a whole come in. Congress is responsible for determining that there is a compelling need to continue the program.

During the 1998 consideration of a highway/transit reauthorization bill, Congress looked in detail at the need for the DBE program. Many members affirmed that discrimination against women and minorities persists, citing not only their own experience in their states and districts but evidence from sources like disparity studies. Members cited differences between the percentage of businesses that minorities or women own and the percentage of construction earnings that they receive. Members spoke of the differences between the loan amounts and terms received by white as compared to minority firms, and of the particularly difficult times minority and women-owned firms have in obtaining financing. Tellingly, members cited examples where minority and women-owned business

participation fell dramatically when goal-based programs were eliminated, or of situations in which, within a jurisdiction, DBE participation in Federal contracts was markedly more robust than the participation in state or locally-funded contracts that did not involve race- or gender-conscious programs. We would like to provide a copy of the 1998 debate for the record.

Those Congressional debates took place 11 years ago. What is the situation now? The Department believes strongly that, while substantial progress has been made, discrimination and its effects continue to exist today and to distort contracting opportunities for DBEs. While race-neutral programs have had heartening successes in some places, it is clear to us that there is a compelling need to continue to make race-conscious measures available, since use of this tool is often the only means of redressing the inequities we see in the transportation contracting marketplace.

One way we have of assessing the need for race-conscious measures is to look at the way that our recipients have structured their goals. Under our rules, recipients must meet as much of their overall goals as their evidence tells them they can through race-neutral measures. For meeting the remainder of their overall goal they have to rely on race-conscious measures. This means that if they could not use race-conscious measures, they would be unable to achieve levels of DBE participation consistent with a discrimination-free competitive environment. They would be unable to redress the effects of discrimination.

From 2004 – 2008, FHWA recipients and large FTA and FAA recipients of which we have current records have set overall annual goals in some 619 instances. In 81 percent of these cases, recipients have found it necessary to establish race-conscious goals.

This means that, eight out of ten times, our recipients, if denied the availability of race-conscious goals, would have left unremedied the effects of discrimination on small, disadvantaged business. Moreover, in 69 percent of these cases, the race-conscious component of the goal was needed to make up the majority of the entire overall goal. In the absence of race-conscious goals, the gap between a level playing field and the reality facing DBEs trying to find work with our recipients would have been significantly larger.

We would like to provide for the record a chart displaying the use of race-conscious goals by recipients in all three operating administration's programs, as well as the recipient-by-recipient data about DBE goals and achievements on which this chart is based.

As the result of a court decision (Western States Paving Co. v. United States and Washington State Department of Transportation, 407 F. 3d 983 ((9 th Cir., 2005))), we have had something of a laboratory experiment of the effect of denying race-conscious tools to recipients. This decision in effect prohibited jurisdictions in the 9th Federal Judicial Circuit from using race-conscious measures until they had conducted disparity studies. Meanwhile, recipients in the 9th Circuit had to use all race-neutral programs. When we observe notable decreases in the participation of DBEs coinciding with the sudden unavailability of race-conscious measures, we see the footprints of continuing discrimination.

We've looked at the DBE participation records of recipients in the 9th Circuit and we found the following: in the highway program, seven of the nine states' DBE participation declined between 2004 and 2007. Among airports, 18 of 28 experienced declines, as did seven of nine transit authorities. We would like to provide for the record charts displaying the information on which this calculation is based.

Not only has overall participation declined, but we have noted many cases in which recipients who were forced by the Western States decision to suspend the use of race-conscious have had difficulty in achieving DBE participation consistent with the nondiscriminatory level playing field they had estimated in setting their overall goals. For example, in 2007 and 2008, Arizona DOT set overall goals of 9.1 and 9.9 percent, and was able to achieve only 3.8 and 3.1 percent, respectively. California DOT set goals of 10.5, 10.5, and 13.5 percent in 2006, 2007, and 2008 and obtained only 8.2, 6.6., and 4.6 percent DBE participation in those respective years. Sound Transit goals were 15 and 13 percent in 2007 and 2008; its achievements were 8.6 and 6.8 percent in those years. Portland's airport set goals of 7.3 and 4 percent in 2007 and 2008, achieving only 2 and 1.1 percent DBE participation in those years. Our recipients' job is to ensure their Federally-assisted contracting programs provide nondiscriminatory access to business opportunities on a level playing field, as defined by their overall goals. Take away the ability to use race-conscious goals, and the recipients can't, in many cases, get that important job done

The effect of the loss of DBE contract goals is very evident to small disadvantaged businesses as they seek business day-to-day. DBEs describe a dramatic drop off in the opportunities to compete for business when race-conscious measures become unavailable. For example, when race-conscious goals were suspended in California following the Western States decision, a DBE contractor told State officials, since "there's no DBE participation goal, our phones have stopped ringing...we don't get calls any more." Another DBE contractor spoke of about a roughly 50% drop off in calls. A woman-owned construction business added that "where there are no goals, I can tell you that the fax machines stop...The next day I got no faxes, the phone didn't ring, asking for my bid. I used to get maybe 20 faxes a day...now I might get three a week."

A lot of the barriers that create the disadvantages that the DBE program is intended to remedy are well known: lack of access to capital, bonding, insurance, and other resources. Some examples include:

- An Idaho woman contractor commented that, despite good credit, it took her firm five years to get financing that a male acquaintance got after three months in business.
- A Texas minority contractor related being turned down for a \$20,000 line of credit by a major bank even though he had a \$20,000 CD to back up the loan.

- Several California contractors mentioned that prime contractors often imposed higher bonding or insurance requirements than the state required, blocking them from participation.
- One female contractor in California commented that “minorities and women have a much harder time getting capital, getting bonding, getting insurance...in bonding... women are still asked to have their husbands sign at the bank...”
- A minority contractor in Washington State told of the following situation he had encountered in trying to get financing:

“My first commercial loan, I applied for a...line of credit, and I was turned down...And one of my white employees [said] ‘Let me see your financial statements’...He walked down to same bank and walked into the same office and talked to the same loan officer and got a call three days later saying ‘You’ve got the loan’...We walked into the bank...and the bank officer doesn’t know who I am...and says to [the white employee] ‘You’re the kind of businessman we’re looking for. I love your financials. We want to do business with you’...And then [my employee] says ‘Let me introduce you to Mr. ____, who was here less than a week ago...’ From then on, until I got much bigger, I never went into a bank without...a white employee.”

As in the Washington State contractor's case, blatantly discriminatory attitudes sometimes play a role. In Idaho, for example, a female business owner related that a prime contractor would not give her specifications or allow her to bid on a private sector project because of her gender. A Hispanic contractor said it was not allowed to provide a proposal on a private contract because of ethnicity, the prime contractor explaining that it did not trust his work ethic. A Native American firm reported harassment of female construction workers that caused them to quit. Another female contractor said that “some contractors think we should not, as women, be on the job.” She also mentioned that “comments and attitudes...wisecracks” often create a hostile workplace environment that affects her bidding, negotiating, and getting a job.

One of the most important barriers to participation encountered by minority and women-owned contractors is their lack of access to the informal networks of communication and relationship that are so important to success in the contracting business. In California, a female contractor said “There’s still very much an old boy network ...and if you’re not an old boy, you’re not in that network [and] there’s a lot of information you don’t get. [At the] golf course...information flows.” An Asian DBE owner said prime contractors always use the same subcontractors and “don’t see any reason of cultivating relationships [with and] providing jobs to new DBE firms” Another DBE firm owner commented that the “number one thing [that] puts DBEs at a disadvantage” is lack of access to decision makers, who “maybe ... go out to drinks every once in a while...or see each other on the golf course.” Non-DBEs, a trade association commented, do not trust DBE firms because they do not know them. Another trade association representative commented that “Lots of

things get done with back slapping and who knows who and if you're not in that group you might as well not come to the party."

Similarly, in Idaho, a DBE said that people get comfortable working with other people and they socialize outside of work on hunting trips, for example. An Idaho Hispanic contractor described the network there as "white guys that have been running around with the same white guys that have controlled the money in the valley for [many] years." In Illinois, a female contractor recounted going to the meeting of her local contractors' association; she was the only woman present out of over 200 attendees, and no one would talk to her.

In our experience in operating this program for nearly 30 years, possibly the most important function it performs is to address the lack of access by minority and women contractors to these crucial informal networks. Many prime contractors do not regularly socialize with African-American, Hispanic, Asian, female etc. contractors. But when there is a race-conscious goal on a contract, they are required to make good faith efforts that involve contacting DBE firms whose owners may not be part of their normal circle. This is a very beneficial way of introducing prime contractors to DBEs and, hopefully, beginning to create business relationships that will lead to opportunities for DBEs to get the work the need to succeed.

When we're examining evidence of the continuing compelling need for a race-conscious DBE program, one of the most important sources we have are disparity studies conducted around the country. These studies are very useful for providing detailed evidence of the ongoing presence of discrimination as well as the current effects of past discrimination. They examine, in a statistically sophisticated way, the differences between the availability and actual use of disadvantaged businesses and the degree to which these differences can be attributed to discriminatory distortions in the marketplace.

These studies paint an indelible picture of a nationwide problem, not limited to any particular minority group or any region of the country. While there are some differences among state and local jurisdictions, that picture is one of consistent underutilization of all the groups the DBE statutes and DOT's regulation presume to be disadvantaged. That is powerful evidence of discrimination. We would like to provide for the record a chart summarizing the underutilization findings of a significant number of disparity studies that have come to our attention, and we have in addition provided copies of these studies to the Committee.

Disparity studies also perform another important function, by collecting first-hand stories of how discrimination affects individual people trying to compete on an uneven playing field, some of which I have mentioned in this statement. These stories put an important human face on the abstractions and statistics that so often dominate the debate about race-conscious programs. We would like to provide for the record a summary of some of the real-world experience DBEs have had with discrimination and other barriers to participation in the marketplace that necessitate something like the DBE program.

In our experience, DBE companies are often reluctant to complain to us or to state or local governments about discriminatory treatment, for fear that rocking the boat will make it very difficult for them to get work. DBEs who participated in the disparity study process were often spoke of this fear of retaliation.. For example, an Austin, Texas contractor said that minorities and women who experienced discrimination “hesitate to use complaint procedures of public entities because they will get blackballed.” Another experienced retaliation for bringing what he felt was a one-sided contract to Texas DOT’s attention, in that it was never interviewed for another contract for which the firm was perfectly qualified.

There are complaints that cast light on potentially discriminatory situations in various jurisdictions. From 2005 to the present, the Department itself has received 34 complaints alleging discrimination against DBEs in the highway, airport, and transit programs.

For example, a DBE owner alleged that a large prime contractor only used the DBE firm to secure a contract and that the DBE’s work never actually materialized. The Department’s OIG investigated and found that the prime contractor had falsely represented that it met DBE requirements. In another case, a DBE alleged that a prime contractor committed to use a DBE just long enough to get a contract, and then quickly replaced the DBE with a non-DBE contractor. Other complaints have raised a variety of issues, such as improper goal-setting practices, exclusion of minority-owned bidders, harassment of DBE firms, failure of bidders on prime contracts to make good faith efforts to secure DBE participation. We would like to provide for the record a chart summarizing examples of both open and closed complaints that our agencies have received.

We believe that the information that is available, both the statistical evidence and the anecdotal stories, clearly indicate that there is a continuing need for our DBE programs to combat discrimination and the current impacts of past discrimination nation wide. The Department of Transportation has a compellingly necessary, quite successful, and narrow-tailored program to redress discrimination and its continuing effects in DOT-assisted contracting. We are continually working to improve it. We have held a series of large stakeholder meetings in the last several months, and have issued guidance and rulemaking documents inspired by the participants’ comments. The stakeholders include representatives from the prime contracting, DBE, and state and local government communities. We would ask the Committee to take notice of statements on this subject that have been made by members of Congress or witnesses at hearings in recent years, and would like to provide for the record a list of links to statements and information that have been presented to Congress on this subject. We also would like to provide for the record a series of publications in the media that have discussed the persistence of discrimination and barriers to the success small disadvantaged business, as well as the effects of the termination of race-conscious goals on the opportunities of DBEs.

Recently, we have issued a final rule to adjust the small business size standards in the rule for inflation. We are also considering how to respond to concerns expressed in the stakeholder meetings about such issues as ways of streamlining the certification process for companies that wish to work in more than one State, and reducing the frequency of

recipients' overall goal submissions to the Department. We would like to provide for the record a copy of the final rule.

If the DBE program is to work well, it's crucial to ensure that its operations are transparent and honest. Our Office of Inspector General (OIG) has made rooting out DBE fraud one of its priorities, and its successes in obtaining civil settlements and criminal indictments and convictions is fair warning to those who would try to take improper advantage of the program. During the last 5 years (October 1, 2003 through September 30, 2008), OIG investigations of DBE fraud allegations have resulted in 49 indictments, 43 convictions, nearly \$42 million in recoveries and fines, and 419 months of jail sentences. Through conferences, publications, and videos, OIG has also carried out an aggressive fraud awareness program. We would like to submit for the record some examples of the kinds of enforcement actions that have resulted from OIG investigations of DBE fraud.

DOT's other agencies are also working to ensure accountability and transparency in the DBE program. The Federal Transit Administration is engaged in a series of oversight visits to certifying agencies. The Federal Highway Administration and Federal Aviation Administration have stepped up operational oversight of the DBE program in their areas of responsibility. We intend to continue this important process of getting information to help us improve the program.

With significant additional transportation funding becoming available quickly because of the American Recovery and Reinvestment Act (ARRA), the Department has an unparalleled chance to make sure that DBEs have a nondiscriminatory opportunity to participate in the recovery from the current recession. Congress made clear that the DBE program applies to ARRA-funded projects, and the Department has issued guidance emphasizing this to our state and local partners. The DBE program will allow us to ensure that all American businesses benefit, without being held back by discrimination, from this opportunity.

Thank you again, and Mr. Ashby and I will be happy to respond to any questions you may have.